Practical Guide on duties and liability of company directors

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DISCLAIMER

This Guide is prepared for information purposes only, in relation to some aspects of Spanish regulations on duties and liability of company directors. Therefore, the information in this Guide is general and is not legal advice.

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PRACTICAL GUIDE ON DUTIES AND LIABILITY OF COMPANY DIRECTORS

Introduction 1

This Guide analyses and describes, mainly from practical standpoint, the duties and liability of directors of a Spanish capital stock company. It intends to clearly explain how directors should behave to fulfil their duties and provides guidelines on how they should perform their functions.

The following matters regarding the functions of directors will be examined:

a) binding duties;

b) civil liability rules;

c) liability actions;

d) special liability situations;

e) liability for the conduct of executives; and

f) defence mechanisms against liability actions.

In putting together this Guide, we have taken into account the following: (i) the Capital Stock Companies Act (the "**Act**"), reformed by Act 31/2014 of 3 December to improve corporate governance, (ii) the recommendations for good corporate governance, currently set out in the Code of Good Governance for Listed Companies, approved in a resolution adopted by the board of Spain's Securities Market Commission (*Comisión Nacional del Mercado de Valores*) on 18 February 2015 insofar as they relate to generally accepted practice for the adequate operation of governing and management bodies of companies and (iii) the Insolvency Act, which clearly has a bearing on the duties and liability of company directors.

Binding duties of directors | 2

The Act requires that directors act diligently and loyally with respect to the company. This obligation is addressed in specific rules of conduct which include these general duties in each individual case.

2.1 Duty of care

All directors should act with the diligence of an "orderly entrepreneur". This duty of care is defined in the Act as a guideline for conduct and source of obligations. All directors should fulfil the various duties foreseen by law, in the articles of association and other internal rules of conduct of the company, with this standard of care. In turn, the fact that all directors should act as orderly entrepreneurs means that, when performing their functions, they should act according to this model of conduct: they are obliged to act as would an orderly entrepreneur in each case. To effectively perform the functions means fulfilling the other duties referred to in this Guide, such as the duty to supervise or control how company affairs are evolving and the duty to be adequately informed.

However, this duty of diligent conduct is not defined in abstract terms, irrespective of existing circumstances. Amongst the circumstances to be taken into account when determining the scope of this duty, such as, the characteristics of the managed company, we will focus on the following: (i) the structure of the management body and the position of directors in that body, and (ii) the management body's duty within the company being managed.

(i) A company may be administered by a management body adopting various forms (sole director, joint or joint and several directors, board of directors). This structure should be taken into account when assessing the required standard of care, as it has a significant bearing on how directors should perform their duties. The capacity to act of a joint and several director, who individually holds all of the company's management and representation powers, is different from that of a member of a board since the will of the board of directors materialises through resolutions and, as foreseen by law, the board of directors is collectively entrusted with representing the company.

Similarly, not all members of the board of directors can be treated equally as regards the conduct expected of them. The complexity of managing the company through a board of directors means that each member's position on the board should be taken into account, as well as his/her functions and duties. It is not uncommon for a board to include specialised or delegated functions, and for there to be various positions for organisation and operation purposes. The standard of care expected of an executive director cannot be the same as that expected of a non-executive director; nor can the chairperson and a member of the board be expected to act in the same way.

(ii) The tasks assigned to a management body of which a director is part makes sense if the company is administered by a board of directors, as these tasks may differ depending on the type of company being managed.

The functions of the board of directors in listed companies tend to be different than those of unlisted companies. The board of directors of a listed company, without prejudice to the functions foreseen in the Act, are generally assigned duties in the articles of association or internal regulations essentially to control and supervise the management carried out by executive bodies and the company's management team. On the other hand, in unlisted companies, the board of directors is usually entrusted with ordinary corporate management tasks.

If the company is administered in another way, by a sole director or by several directors, acting jointly and severally or just jointly, all directors are required to fulfil the same functions when managing the company.

2.1.1 Duty to perform the functions effectively

Directors are appointed to effectively administer and represent the company. To do so diligently, they are expected to be proactive, to be actively involved in the tasks entrusted, both in terms of management in various fields –e.g. by issuing general policies and strategies, appointing executives or carrying out ordinary management tasks– and other duties related running the company, e.g. calling general meetings, drawing up annual accounts or preparing and drafting reports.

If the company is administered by a board of directors, effective performance is especially relevant, as this is the only way of ensuring that the board of directors executes the duties entrusted effectively. Consequently, there is also a greater risk that some directors may not pay sufficient attention to the performance of their functions.

Consequently, we refer to some conducts which could be seen as confirming effective performance by a director, without prejudice to them having to be adjusted to particular situations. A director will be deemed to be performing his/her functions effectively if he/she acts as follows:

(i) dedicates the necessary time and effort to regularly oversee any matters raised in the company's administration;

(ii) previously examines the agenda of any scheduled board meeting and, if possible and appropriate, requests that additional items be included;

(iii) adequately prepares the meetings of the board and of any delegate bodies or committees in which he/she may be involved (e.g. analysing the information provided before the meeting and gathering any other that may be relevant, requesting clarifications or asking any questions that he/she deems appropriate), in order to ensure informed deliberation at the meetings;

(iv) personally attends, participates and actively contributes to the discussions of the board of directors and of any delegate bodies and committees, putting forward for debate any matters deemed relevant, even if not included on the agenda;

(v) if he/she is unable to personally attend a board meeting, gives the relevant instructions to enable a proxy holder to do so;

(vi) requests that the board chairperson call a board meeting or together with other directors triggers the calling of a meeting, to discuss matters of interest to the company's management; and

(vii) monitors the implementation of the resolutions adopted and ensures that they are fulfilled.

2.1.2 Duty of surveillance or supervision

This duty also entails the responsibility to actively and continually supervise the company. All directors should adopt the necessary measures to ensure that the company's activity is effectively controlled. Each individual director is bound by this duty, but its compliance depends on the structure adopted by the management bodies and the tasks entrusted to them. Consequently, directors are required to supervise the bodies and persons to whom they delegate their powers (e.g. CEOs or executive committees) and the work of executives. If the management body administers the company effectively, this surveillance mainly focuses on the work of executives. In any case, surveillance entails the duty of directors to supervise and ensure that the company management meets the required objectives and accomplishes the company's object and interest.

As a result, this standard of care basically requires that all directors be aware of the most relevant management decisions taken, and how resolutions or decisions are adopted in a more general manner, such as general policies or strategies. Therefore, directors are required to take initiative to effectively perform their functions.

This care requires taking into account various financial and non-financial risks (such as operational, legal, environmental or reputational risks) that may affect the company, and establishing and verifying appropriate devices for risk identification and control.

Fulfilling this duty of surveillance or supervision should be made compatible with the responsibilities inherent to the company's management, and may involve the fulfillment of some formalities, which may be more or less complex depending on the case (e.g. establishing the manner in which a company's premises may be accessed, or how to contact an executive). Clearly, this duty includes considering the most appropriate measures to enable effective supervision, without the abovementioned responsibilities being affected.

This task being fulfilled by a member of the board of directors is somewhat peculiar because of the collegiate nature of this body. Also worth highlighting are some guiding conducts of directors, closely related to the duty of information referred to below. Consequently, a duty of surveillance or supervision entails

(i) requesting that the board chairperson provides information about the management, or allowing certain types of inspection on the company or its premises;

(ii) requesting the chairperson that a board meeting be attended by CEOs or by members of an executive committee, including any executives reporting to the same, and proposing to the chairperson or board that executives be appointed or removed, as the case may be;

(iii) informing the board chairperson or the board itself of any defects detected in the company's control systems and proposing improvements;

(iv) informing the board chairperson or the board itself of any misuse or malpractice detected in the company's management;

(v) warn the board chairperson or the board itself of any risks discovered, proposing measures to deal with them.

2.1.3 Duty to be informed

All directors are obliged to request, and are entitled to receive, any information that is adequate and necessary to perform their functions and fulfil their duties. Obtaining and analysing this information is essential to ensure that all directors act diligently, as only informed directors can adopt the necessary measures and decisions for the company's good governance. This is a right and a duty for directors, irrespective of how the company's management is organised, even if this organisation affects how the right is exercised or the duty fulfilled. Specifically, in the case of a board of directors, the information that directors have guarantees, on the one hand, the fulfilment of collegiate duties by encouraging deliberation regarding the different interests and points of view and, on the other hand, effective compliance with the board's duties. As mentioned, only a duly informed director can effectively carry out the company's management.

Access to information has a clear material scope. All directors are obliged, and entitled, to request, receive and access any documentation, data and facts related to the company's activity, in order to adequately perform their functions and tasks. This information may also be requested with regard to specific management decisions.

The consequences of performing this duty should also be taken into account, and the management body's structure is relevant in this context. Access to sufficient information becomes more complex if the company is administered by a board, rather than by a sole director or by several directors acting jointly and severally or just jointly. For instance, if the company has a board of directors, all directors should have access to the necessary information before a board meeting takes place so that they can deliberate and adopt resolutions on the matters to be discussed, as this is the only way for them to participate and contribute to the board's meetings in an active and informed manner. They may also request explanations regarding any deliberation at the meeting. In turn, the characteristics inherent to the collegiate operation of the board and the uniqueness derived from the specialisation or decentralisation of its tasks should be taken into account in relation to the duty to be informed.

Consequently, a director may address the board chairperson or secretary to request any information deemed appropriate, also in relation to the conduct of CEOs or executive directors.

2.1.4 Protecting business judgement

Managing a company involves a significant margin of discretion in decision-making, particularly in management, strategic or business decisions. The business and strategy decisions adopted by directors are not an exact science, and their outcome is uncertain. When facing various alternatives, it is not always easy to determine which one is best from a business point of view at the time the decision is made, even if things may appear different in hindsight. When directors accept their appointment, they do not undertake to guarantee the company's economic and business success, but to perform their functions and tasks at all times in compliance with the Act, the company's articles of association and the required standard of care.

In the United States, a rule has been developed to protect business discretion, known as the Business Judgement Rule. This rule limits directors' liability in relation to any business decisions adopted that are not ultimately successful for the company. According to US courts and tribunals, a business failure cannot constitute a cause on which to claim damages from the company's directors. At most, it may entail the director's dismissal and, at the very least, a decrease in his/her remuneration. The conclusion is that judges cannot examine whether or not a business decision is adequate, but may only determine how the decision was taken.

Spanish law has undergone a recent reform to include a rule to protect directors, following the example of the Business Judgement Rule. Consequently, protecting business discretion has become a measure used to protect the right of directors to adopt strategic and business decisions. In this way, so long as directors take decisions in good faith, have no personal interest in the matter decided upon, are sufficiently informed (e.g. with the support of experts in the field or according to expert reports) and follow an adequate decision-making process (e.g. by examining various alternatives and analysing the effect that the decision will have on the company), the decisions will be presumed to have been adopted in a diligent manner. In this way, by not making directors liable for unsuccessful decisions if they are adopted diligently, they are protected when taking strategic and business decisions.

However, this business discretion protection does not apply to decisions adopted by directors that personally affect other directors and related persons. Specifically, this protection rule does not apply to any decisions taken by directors to authorise transactions in which they have a conflict of interest.

2.2 Duty of loyalty

A duty of loyalty requires that directors perform their tasks at all times in the company's best interest. Their conduct, also in this case, should follow a pattern of conduct established by law: all directors should perform their functions with the diligence of a loyal representative; a director is expected to act as would a representative that is loyally representing its principal. This duty of loyalty requires that a director acts in good faith, guided by what is most favourable for the company he/she is managing. This requirement is imposed on a director in relation to the duties binding him/her as regards the company's administration and representation, irrespective of the structure adopted by the management body and the functions or tasks executed within by the directors, and irrespective of the management body's role in the company. Both in the case of a board of directors, which tasks are mainly those of control and supervision, and a board that effectively administers the company, all directors have the same duties of loyalty in relation to the company's best interest.

The fact that this loyalty is defined in relation to the company's best interest, which the shareholders determine based on their common interest, means that all directors need to report and explain their management. The general meeting is entrusted with approving the management of directors as company representatives.

Furthermore, the duty of loyalty is public and mandatory; consequently, any provisions in the articles of association that limit or reduce it or are contrary to the same will not be valid. However, this duty of loyalty does not mean that directors are subject to absolute prohibitions on how they can act. The interests being protected also include the relative nature of any prohibitions established, which means that the company may waive these prohibitions.

2.2.1 Duties inherent to the duty of loyalty

Due to the impact of good corporate governance models, duties of loyalty have gradually become more regulated, and the types of conduct that these duties involve have been specified. At present, a duty of loyalty requires that all directors

(i) perform their functions with the loyalty of a loyal representative, acting in good faith and in the company's best interest;

(ii) not exercise their powers for purposes other than those for which they were empowered (e.g. in the articles of association or a power of attorney);

(iii) not disclose information, data, reports or background facts they have accessed while in office, even if they are no longer in office, except when permitted by law or when so formally required;

(iv) not participate in the deliberation and voting of any resolutions or decisions where the director or a related person has a direct or indirect conflict of interest; however, they will not abstain from any resolutions or decisions affecting the director as such (e.g. his/her appointment or revocation in positions on the board of directors);

(v) exercise their powers at their sole risk, with freedom to decide and independence from third party instructions and relations; and

(vi) adopt measures to avoid situations where their own or third party interests may conflict with the company's interest and their duties towards the company.

2.2.2 Special reference to the duty to avoid conflicts of interest

(A) Conflict of interest situations

Avoiding conflict of interest situations is a very important aspect of the duty of conduct of directors based on the duty of loyalty. This is probably the most distinctive duty of conduct (based on loyalty). A conflict of interest will always arise if the director is in a situation where his/her interests may conflict with those of the company. Therefore, this conflict of interest does not need to be current and may arise regardless of whether it is ultimately detrimental to the company. The possibility of a director not acting in the company's best interest in order to satisfy a different interest, either for himself/herself or for another party, constitutes a conflict of interest situation.

This duty to avoid conflict of interest situations imposes a duty of conduct on directors, consisting of their abstention or a passive obligation. Specifically, directors undertake to

(i) not execute transactions with the company; however, a director may carry out ordinary company transactions if executed in the same conditions applied to its clients, and provided that information is not necessary to present a true and fair view of the company's equity, financial situation and results;

(ii) not use the company's name or take advantage of his/her director status to unduly influence private transactions;

(iii) not use the company's assets and confidential information on the company to which he/she has had access as director, for his/her own purposes;

(iv) not take advantage of the company's business opportunities to his/her own benefit;

(v) not obtain benefits or remuneration from third parties, other than the company and its group, related to performing his/her functions as director (e.g. receiving a commission from a third party hired by the company), except for acts of common courtesy; and

(vi) not compete with the company. This duty affects any activity in which the director is involved, whether on his/her own –as entrepreneur– or on behalf of another –as director, executive or, even, as another company's employee– that may constitute –actual or potential– effective competition. Effective competition may exist even if the director's activity is not the same, similar or complementary type of activity as the company's object (although most infringements are likely to arise in these cases).

A director's activity will constitute effective competition if it is carried out within a specific time span and geographical area which, functionally speaking, is capable of harming the company's interest and is also material.

In turn, a director may not carry out any activities that otherwise place him/her in a permanent conflict with the company's best interest.

(B) <u>Related person benefiting from forbidden acts or activities</u>

The duty to avoid conflicts of interest (e.g. to not compete with the company) also applies when persons related to directors benefit from the forbidden acts or activities (e.g. when directors execute transactions with the company or when they take advantage of the company's business opportunities).

(C) <u>Duty of abstention</u>

All directors will in any case refrain from carrying out any of the activities set out in section 2.2.2 (A) above, unless the company authorises this through the general meeting or management body, as the case may be.

(D) <u>Duty of communication and information in the annual report</u>

This duty covers any conflict of interest situation. Furthermore, a director should communicate any conflict of interest, whether direct (e.g. when the director's interest conflicts with that of the company) or indirect (e.g. when it is the interest of someone related to the director which conflicts with the company's interest). This duty aims to provide greater transparency in conflict of interest situations, encouraging awareness and, consequently, increasing control over directors.

(i) Activities to be communicated

Although, as mentioned, this duty of communication refers to any conflict of interest situation, for practical reasons, we refer to those activities which may imply effective competition with the company. Directors should inform the company of the following activities:

(a) Those in which the director is directly involved, personally or on behalf of another (whether or not with the same, analogous or complementary type of activity as the company's object), which put him/her in a conflict of interest situation with the company. For example, a director must notify (1) any holdings in other companies, which may conflict with the company (including controlling stakes); and (2) any commercial or employment positions held by the director in other companies, which may entail a conflict of interest with the company.

(b) Those carried out by persons related to the director, individually or on behalf of another (whether or not with the same, analogous or complementary type of activity as the company's object), putting them in a conflict of interest with the company. For example, information must be provided regarding (1) any holdings in other companies of the person related to the director, entailing a conflict of interest with the company (including controlling stakes); and (2) any commercial or employment positions held by the person related to the director, entailing a conflict of interest with the company.

Once the company is informed of the conflicting activity, the director in question need not update the information provided, unless changes take place that could alter his/her conflict of interest with the company.

(ii) Addressee of the information

If the company is managed by a sole director, the general meeting will be informed. However, if the company is managed by several directors, the other directors will be informed; and if the company is managed by a board of directors, the director in conflict will inform the board, addressing the board chairperson (who is the person in charge of receiving company notifications and who will forward the communication to the other directors).

(iii) Information to be included in the annual report

Any conflict of interest situation should be included in the report attached to the company's annual accounts. Consequently, the annual report will reflect any type of information notified by the directors in relation to activities that actually or potentially compete with the company or constitute a conflict of interest. The annual report will also include any information notified by the directors in relation to conflicts of interest of related persons.

2.2.3 Waiver and authorisation rules

In some cases, a director or a related person can legitimately be authorised to execute a transaction with the company, to use specific corporate assets, to take advantage of a business opportunity, to obtain an advantage or third party remuneration. As a general rule, this is authorised by the company's management body and, exceptionally, by the general meeting.

(A) <u>Authorisation by the management body</u>

If the general meeting's authorisation is not necessary, this authorisation will be granted by the management body, provided that the independence of the authorising directors with respect to the director requesting the authorisation is guaranteed. The principle underlying this rule is that any directors affected by a conflict of interest situation may not participate in the decision in question. Before a transaction can be authorised, the authorising directors must make sure that it is not detrimental to the company's equity or, as the case may be, that it meets the necessary transparency requirements and is carried out at arm's length.

(B) <u>Authorisation by the general meeting</u>

The general meeting must authorise the following activities:

(i) obtaining an advantage or remuneration from third parties;

(ii) any transactions valued at more than 10% of the company's assets; and

(iii) a prohibition to not compete with the company (in an express and separate resolution), if (a) detriment to the company is unlikely, or (b) profits are expected to be made which will compensate the damage.

Directors' civil liability | 3

All directors are liable for fulfilling their duties in performing their functions. Although there are various forms of liability, depending on which legal system applies –e.g. criminal or administrative– this Guide focuses on civil liability, which may be of two types:

(i) internal: directors are liable for a breach of their duties, vis-à-vis the shareholders and the company itself; and

(ii) external: directors are liable to any third party whose interests have been directly harmed, and particularly the company's creditors.

The company, its shareholders and third parties may bring the liability actions analysed in section 4 against directors.

The liability rules applicable to directors are designed to have a preventative effect, i.e. they aim to incentivise directors to fulfil their duties, increasing control over their management, and to remedy any harm caused to the company, its shareholders or third parties.

3.1 Nature

The liability that directors may incur is:

(i) a legal liability, because their binding obligations and the consequences of not complying with them are established by law;

(ii) an organic liability, because a natural or legal person is required to act as company director;

(iii) a personal liability, because a legal or natural person -not the management body- is required to act as director;

(iv) a joint and several liability, based on the presumption that the damage caused is a result of the conduct of all the members of the management body (unless there is evidence to the contrary); consequently, a claim may be brought against any of the directors (e.g. the most solvent one), requesting the relevant indemnification, without prejudice to the director paying the entire indemnification later recovering it proportionally from the other directors; and

(v) a compensation liability, because the liability of directors is aimed at compensating the damage caused to the company, its shareholders or third parties, as applicable.

3.2 Conditions

Directors' will be liable if they intentionally or negligently carry out an illegal act which directly harms the company, or indirectly harms its shareholders or third parties (e.g. the company's creditors), or if this act is directly detrimental to the interests of shareholders or third parties.

For a director to be held liable, the following conditions must to be met in addition to the general rules on civil liability:

(i) an act or omission by the director;

(ii) the act or omission is contrary to applicable regulations or the company's articles of association, or constitutes a breach of director duties;

(iii) the act or omission causes actual damage that can be quantified economically, either to the company or to the interests of its shareholders or third parties; the damage caused includes both actual damage (an actual and effective decrease in equity) and lost profit (the profit that in all likelihood, or almost certainly, the damaged party would have no longer obtained);

(iv) the director's conduct is intentional or negligent (it is presumed, unless there is evidence to the contrary, that negligence exists if the act or omission is contrary to applicable legislation or the company's articles of association); and

(v) the damage caused is a consequence of the director's act or omission, in such a way that a causal link exists with his/her conduct (excluding any damage caused by unforeseeable events or which, although foreseeable, were unavoidable).

3.3 Liable parties

Any person acting as a company director is bound by the rules on directors' liability. Consequently, provided that the preceding conditions are met, both *de facto* and *de iure* directors may be held liable. *De facto* directors are also bound by any legal duties imposed on *de iure* directors.

To this end, *de iure* directors are those registered at the Commercial Registry as company directors, provided that their position is in force. In turn, *de facto* directors are those who meet the characteristics established below.

3.3.1 *De facto* directors

De facto director status is basically related to an effective performance of company management duties. This category has not always been accurately defined and its configuration has gradually changed over time. Broadly speaking, this category includes any situations in which the company has not officially appointed persons to act as its directors. As is often the case in practice and in more restrictive terms, *de facto* directors may refer to previously appointed directors who continue to act as such when their term has expired or when they were incorrectly appointed.

De facto directors will also include any legal or natural persons who instruct the company's directors on how to act in each situation, although this interpretation has been disputed. In any case, *de facto* director status must be proven by the party claiming its existence.

Within the category of *de facto* director, a distinction is usually made between the following:

(i) Apparent directors, who lack valid title to act as directors, whose term has expired or who were incorrectly appointed, but who act as directors in the company's day-to-day business and appear as such vis-à-vis third parties, i.e.:

   a) they act publicly and evidently on behalf of the company;

   b) they hold and exercise powers of representation to which directors are legally entitled;

   c) their conduct is recognised or accepted by the company shareholders; but

   d) they are not registered as directors at the Commercial Registry.

(ii) Shadow directors, who do not act as directors vis-à-vis third parties –as the company has *de iure* directors– but who hold this position without being externally perceived as such (e.g. if a majority shareholder adopts decisions that are later executed by company directors).

Of particular importance, in corporate group situations, is the fact that there is a risk of the parent company or, even, all or some of its directors being presumed to act as *de facto* directors of a subsidiary. Although various interpretation criteria exist, this risk will be greater the higher is the group's level of integration and business centralisation, and the greater is the single power of management exercised by the parent company. However, this requires a case-by-case analysis. In any event, it is not always true that a parent company or its directors act as *de facto* directors of a subsidiary, as the parent company, *per se*, should always exert a degree of control and supervision over its subsidiaries' activities, as competences inherent to the single management it exercises.

3.3.2 Representative of a director legal entity

Legal entities may be company directors and legal entities are often involved in company administration. To this end, a director legal entity must designate a natural person as its representative. This natural person must meet the requirements established by law for directors. It will also be bound by the same duties as directors and will be held jointly and severally liable together with the director legal entity, i.e. liability may indistinctly be claimed from the representative legal entity and the director legal entity.

A representative natural person will never be exonerated from liability on the grounds that he/she is following the instructions of the director legal entity, naturally without prejudice to any internal relationship that may exist between them.

3.4 Effects

3.4.1 Scope and allocation of liability

The structure adopted by the management body should be taken into account when determining the liability of its members. A management body may adopt the following structures:

(i) a sole director;

(ii) various joint and several directors, that is, any one director may perform his/her functions individually without having to act jointly with other directors;

(iii) two directors (or more, in the case of limited liability companies) acting jointly, that is, they need to act together to perform their duties; and

(iv) a board of directors.

The structure adopted inevitably has a bearing on the conduct of directors and, to that extent, affects the applicable liability rules.

For sole directors and joint and several directors, their ability to act individually means that they are liable for any damage that may be individually attributed to them. On the other hand, for joint directors and boards of directors, it is not always easy to individualize such liability, as the damage is a result of a resolution or act adopted by several persons. According to law, all the members of a board of directors carrying out an act or adopting a detrimental resolution will be jointly and severally liable. On the one hand, this means that each director, if so required, will be obliged to repair the damage caused in full; and, on the other hand, the compensating director may recover from the other directors the amount payable by each one. This action may only be brought against those directors who caused the damage.

For companies that have a board of directors, if its powers have not been permanently delegated to one or several CEOs, the company's executives will be bound by the same duties and responsibilities as company directors, without prejudice to the company being able to bring action against them according to contract entered into with them.

3.4.2 Dismissal of directors

If the general meeting approves a resolution to bring a corporate liability action (as defined in section 4.1 below) against the directors, the affected directors will be automatically and definitively dismissed, even if the claim is rejected in court. However, if a corporate liability action is brought by the minority shareholders or by the company creditors, the affected directors will not be automatically dismissed, without prejudice to their dismissal being requested by the shareholders at the general meeting.

Liability actions | 4

All directors may be held civilly liable through a corporate action and/or an individual action.

4.1 Corporate liability action

In order to be able to bring a corporate liability action, directors must have infringed their director obligations and, as a consequence, have caused harm to the company.

A corporate liability action may be brought:

(i) Firstly, and on a preferential basis, by the company. This requires a simple majority resolution at the general meeting (even if the matter is not included on the agenda), and the affected directors will be automatically and definitively dismissed.

(ii) Secondly, and on a a subsidiary basis, considering that the company may waive this action, it may be brought by shareholders who, individually or jointly, hold at least 5% of the capital stock (in unlisted companies) if:

 (a) the directors have not called a general meeting for this purpose;

 (b) the company has not brought the action within one month following the adoption of the resolution; or

 (c) the resolution was contrary to the liability action.

 Furthermore, if an action is based on the directors' breach of their duty of loyalty, any shareholders meeting the requirements foreseen in paragraph one of section

4.1.(ii) may directly bring this action, and the general meeting's decision would not be required.

(iii) Finally, and on a subsidiary basis, action may be brought by the company's creditors if the company or its shareholders have not brought a corporate action, and the company's equity is insufficient to settle their credits. This action will be filed by the creditors in their own name but in the interest of the company and in particular its equity, as the only way of securing their credits.

As mentioned, a resolution to bring action or to reach a settlement implies that the affected directors will be automatically and definitively dismissed.

4.2 Individual liability action

An individual liability action is an independent action to remedy or indemnify any damage directly and individually suffered by the company's shareholders or by third parties (e.g. the company's creditors), rather than the company, due to the actions of directors. In this case, the damage caused to the individual assets of the shareholders or third parties must be duly proven.

Any shareholder or third party whose individual interests have been harmed will have standing to bring an individual action, if he/she can prove that effective, ascertained and evaluable damage was caused as a result of a director's negligence.

In this case, the action is direct and is the main action. In addition, the liability conditions must be met: (a) damage directly harming the individual interest of the shareholder or third party, (b) a culpable and harmful act or omission by the director, and (c) a causal link between the two. Any shareholders or third parties bringing this action must prove that all three conditions are met.

4.3 Limitation period for liability actions

All liability actions brought against directors, on a corporate or individual basis, prescribe four years following the date on which they can first be exercised.

4.4 Actions derived from a breach of the duty of loyalty

In addition to the liability actions foreseen in this section, and thus consistent with them, actions may be brought to challenge, cease, neutralize and annul, as the case may be, any acts and contracts executed by a director in breach of his/her duty of loyalty.

Special liability situations | 5

5.1 Company dissolution

The law provides for cases when a company must be wound up. Furthermore, all directors are legally subject to a series of duties to initiate a company dissolution process if there are legal grounds for dissolution. If directors fail to fulfil these duties, the law provides for a liability regime in the form of sanctions to protect the general interest, the interests of the company's creditors and security in the course of business. The aim is to avoid having companies involved in dissolution events where the situation is not resolved or the company not wound up.

5.1.1 Directors' duties

If there are legal grounds for dissolution, all directors are obliged to (a) call a general meeting within two months following the event, in order to remove these grounds or adopt a dissolution resolution, as the case may be, or, if necessary (b) apply for the company's insolvency. When a company becomes insolvent, its directors should not initiate a dissolution process but should apply for insolvency. In a situation in which insolvency is presumed to exist, the company's directors are obliged to file insolvency proceedings.

All directors, as part of the diligent performance of their functions, must adopt the necessary measures in this situation, based on the structure adopted by the management body. For instance, if the company has a board of directors, the directors should propose that the chairperson assemble all directors to call a general meeting at which to decide on how to remove the legal grounds for dissolution or to wind up the company. Directors may provide the other directors with any evidence they may have of this situation, requesting any information or explanation they deem appropriate on the existence of a dissolution event and, as the case may be, on any measures that may be adopted to avoid it (even if not included on the agenda of the board meeting). Once the directors present at the meeting are informed and confirm that a dissolution event actually exists, they should demand that a general meeting be called, proposing any solutions. Otherwise, the liability rules foreseen by law apply.

Furthermore and on a subsidiary basis, if a general meeting is not called or if, after being called, those present do not agree to wind up the company, the directors will be obliged to request the company's judicial dissolution. Again, the management body's structure is relevant to this end. In the case of a board of directors, the directors must request this meeting and adopt the resolution required to apply for the company's judicial dissolution. This application must be made within two months following the date scheduled for the general meeting –if not called– or following the date of the meeting, if the resolution is contrary to this dissolution or was not adopted.

5.1.2 Liability rules

The liability derived from a breach of the foregoing duties entails a sanction against the directors in question, for not fulfilling their specific duties. Consequently, no damage or the existence of the other conditions inherent to the civil liability rules applicable to directors and explained above will need to be proved. Only the fact that these duties have not been fulfilled will need to be proved, even if liability is fault-based.

The sanction imposed by law on directors is to hold them jointly and severally liable, along with the company, for any debts arising after the company's dissolution event arose. In other words, creditors may indistinctly claim the payment of their debt from any director individually or from the company itself, provided that the debts are due, liquid and enforceable. In these cases, any company debts claimed will be presumed to be subsequent to the dissolution event, unless the directors can prove an earlier date.

The following is particularly noteworthy in relation to the liability rules applicable to directors in these cases:

(i) The directors and company will be jointly and severally liable. Consequently, if the company eventually pays the debt, it will be cancelled, whereas if payment is made by the directors, they may proportionally recover the entire debt paid in an action brought against the company and the other directors.

(ii) The two-month term in which to call a general meeting will begin to run from the date of the dissolution event. For example, if the dissolution event is based on losses reducing the net equity to an amount that is less than half the capital stock, the date from which the two-month term begins to run is still the dissolution event date, irrespective of when the annual accounts were drawn up.

(iii) A timely application by the directors for an insolvency declaration cancels their liability because the company is not dissolved.

(iv) Directors will not be liable if, during the abovementioned timeframes, the cause of the company's dissolution ceases to exist.

(v) Calling a general meeting, requesting the company's judicial dissolution or filing insolvency proceedings, are all mandatory organic duties for directors, based on the operating rules applicable to the form adopted by the management body.

(vi) If the directors fulfil these duties in an untimely manner, they will only be liable for any debt arising between the date on which they should have fulfilled their duties and the date when they actually did.

5.2 Company insolvency

In a situation of objective insolvency, the company's directors are also bound by specific duties and are subject to special liability rules. On the one hand, because a debtor, in an actual insolvency situation, is obliged to file for insolvency, aimed at obtaining a timely declaration of insolvency to protect its equity and that of all the creditors (since the chances of finding a solution are greater in an insolvency situation). On the other hand, directors may be particularly liable for causing or worsening the insolvency situation to the detriment of the company's creditors, as a closely related consequence of their unresponsive attitude in an insolvency situation. In this case, their assets may be seized from the very start, as is happening in practice, to secure payment to creditors, in order to restore the equity of the insolvent company. Directors may be ultimately ordered to pay, as is also happening in practice, part of the credits that are not settled in the liquidation, if they are declared to be persons affected by the judgment declaring the insolvency as fault-based.

5.2.1 Duty to apply for insolvency

All directors must apply for an insolvency declaration within two months following the date on which they became aware of, or should have known about, the company's actual insolvency situation. To this end, the term "actual insolvency" means the situation existing from the moment the company is unable to promptly and regularly meet its enforceable obligations.

When assessing the directors' capacity to act, how the company's management is structured is also relevant. For example, if the company has a board of directors, its directors should propose to the chairperson that a meeting be held to file for insolvency. At the board meeting (even if not included on the agenda), the other directors should be informed, providing appropriate evidence, that the company is insolvent and that its insolvency should be requested. Directors may request any information or explanation they deem appropriate about the existence of the insolvency situation. Once the directors are informed and have confirmed that an insolvency situation actually exists, an insolvency application should be filed. If the directors do not fulfil this obligation and a request for insolvency is not filed in a timely manner, it will be presumed, unless there is evidence to the contrary, that they have acted intentionally or recklessly and, consequently, a fault-based insolvency would be declared with any ensuing liability, depending on their actions.

Furthermore, directors will be entitled to file for insolvency if insolvency is imminent (rather than current), that is, when the directors foresee that the company will be unable to regularly and promptly fulfil its enforceable obligations. A delayed insolvency application may have consequences on the start of an insolvency situation. The reason for this is that when there are already signs that a company may become insolvent, its directors should file for insolvency in order to enhance their chances of finding a solution in the insolvency process.

5.2.2 Communicating negotiations and effects

In an actual insolvency situation, the company's directors, during the abovementioned two-month term, may postpone and, even, avoid an insolvency declaration provided that they inform the relevant court that negotiations have commenced to reach a refinancing agreement (amongst those expressly foreseen in the Insolvency Act) or to obtain the necessary adhesions to an early arrangement proposal.

Alternatively and within this same period of time, the company's directors may apply for an out-of-court payment settlement, in which case the relevant judge will be informed by the registrar or notary public who designated the insolvency mediator involved in the out-of-court settlement.

Once any of the foregoing negotiations has been notified (refinancing agreement, early arrangement proposal or out-of-court settlement), the debtor will not be obliged to file for insolvency and the company's directors will not be obliged to apply for the company's insolvency; nor may an insolvency be declared at the creditors' request. These effects will last for three months. If, after this three-month period, the insolvency situation has not disappeared, the directors must apply for the company's insolvency during the next business month, unless the insolvency mediator has previously requested this (in an out-of-court payment settlement).

5.2.3 Directors' liability in classifying the insolvency

If any *de iure* or *de facto* directors (as defined in the Guide), intentionally or acting with gross negligence, cause or worsen the company's insolvency situation, the insolvency will be classified as fault-based. The law establishes a series of presumptions, of varying degrees, on situations that evidence this wilful intent or gross negligence by the company's directors.

For instance, insolvency will always be fault-based in the following situations:

(i) if the accounts are not adequately handled, and this breach is material; if a double set of books is held, or if any relevant irregularity is committed to alter the perception of the company's equity or financial position;

(ii) if, during the two years preceding the insolvency declaration, any assets or rights included in the company's equity were fraudulently removed; and

(iii) if, before the date on which insolvency is declared, the company carries out any act to simulate a fictitious equity situation.

Furthermore, unless there is evidence to the contrary, the company's directors will be presumed to have acted intentionally or with gross negligence, amongst other situations, if

(i) they breach their duty to file for insolvency;

(ii) they do not cooperate with the insolvency judge or receiver in insolvency; and

(iii) in any of the last three financial years, prior to the company's insolvency declaration, no annual accounts are drawn up and audited (if this is necessary) or if, once the accounts are approved, they are not registered at the relevant Commercial Registry.

If an insolvency is classified as fault-based, this will have serious consequences for the affected directors, if this is upheld in the classification judgment. This liability will entail

(i) their inability to administer third party assets, and to represent any person, for a period ranging from two to fifteen years, pursuant to what is provided in the insolvency classification judgment;

(ii) the loss of any right held as company creditors, and the obligation to return any assets or rights unduly obtained from the company's equity; and

(iii) an order to indemnify any loss and damage caused to the company.

In turn, once the company liquidation stage has commenced, the insolvency judge may order the affected directors to pay to the insolvency creditors, in whole or in part, any amount eventually left outstanding once the company's assets have been liquidated. This liability will depend on whether the facts attributable to the affected directors, evidencing the conduct that has led the insolvency to be declared fault-based, have caused or worsened the company's insolvency. Furthermore, whenever more than one director is sanctioned, the judgment will itemise the amount payable by each one depending on their level of involvement in the events causing or worsening the insolvency. This circumstance will also depend on how the company's management is structured; if in the form of a board of directors, each director's conduct will be taken into account, as well as his/her level of involvement in the activity that has been taken into account in relation to the cause or worsening of the company's insolvency.

This liability may have implications for a company director from the outset, as mentioned previously. The insolvency judge (*ex officio* or if reasonably requested by the receiver in insolvency) may order a seizure of the assets and rights of any *de iure* and *de facto* directors during the two years prior to the insolvency declaration date, if the insolvency is at all likely to be ultimately classified as fault-based and the directors are ordered to pay the abovementioned amount, in whole or in part. If a seizure of the affected directors' assets is ultimately ordered, a bank guarantee may be provided instead.

5.2.4 Relationship between corporate and insolvency liability

An insolvency declaration does not totally exclude the rules on directors' civil liability, without prejudice to certain implications. A distinction should be drawn between general rules on civil liability and a special liability situation arising from a dissolution event.

Once the company's insolvency has been declared, only the receiver in insolvency may bring a corporate liability action. If this corporate liability action is being processed at the time of the insolvency declaration, it will continue until the judgment becomes final. Exceptionally, any proceedings to claim loss and damage caused to the company, brought against directors prior to the insolvency, still at a first instance stage and provided that the trial or hearing stage has not been completed, will be joined to the insolvency proceedings.

An insolvency declaration does not prevent an individual action from being brought against directors, or a continuation of these proceedings if the claim was filed before the insolvency declaration.

In turn, any claims brought against directors for breach of their mandatory duties, in a dissolution event, will not be granted leave to proceed. If these claims are filed prior to the company's insolvency declaration and the relevant proceedings are still ongoing, they will be suspended until the insolvency process has ended.

Directors' liability vs. executives' liability | 6

Companies usually have a management team entrusted with its ordinary management and the execution of policies and strategies issued by the management body. Directors and executives hold various positions in the company's organisation, and this differentiation also entails an assignment of various tasks, characteristically related to control (for directors) and management (for executives), although sometimes the same person may carry out both functions. This different position and tasks also has various implications on liability, for which we should draw a distinction between the positions of director and executive:

(i) A director is bound to the company under an organic and commercial relationship, empowering him/her to administer the company and represent it vis-à-vis third parties (whether individually or collectively).

(ii) An executive is bound to the company under an employment contract and may act as an attorney, in any case hierarchically dependent on the management body. Furthermore, his/her position does not include any powers to represent the company, without prejudice to any power of attorney that may be conferred.

As mentioned, all directors are obliged to manage and administer the company in order to achieve its object and must at all times safeguard its interests. The liability of directors and their duty of care covers the selection, appointment and training of company executives, and/or the supervision and control of the latter's management and administration. Consequently, the culpability and causal link required to hold a director liable will be met if a director is deemed at fault and not to have acted diligently when fulfilling his/her duties to control and supervise the company's management.

The fact that company directors may, in turn, hold executive status and specifically undertake management tasks is particularly noteworthy. According to the recent corporate law reform, a member of the board of directors may be assigned executive duties. Pursuant to the regulations on listed companies, executive directors are those who perform management tasks in the company or group of companies. In these cases, despite holding this status, they will continue to be bound by the liability rules applicable to directors although, as mentioned, this allocation of duties will be taken into account when determining their standard of care.

On the other hand, an executive is given a specific mandate under a contract covering his/her competences and duties; he/she must ensure that his/her mandate is adequately performed, but is not obliged to supervise and ensure the achievement of the company's object and to protect the company's interest beyond the mandate and functional scope conferred. Any civil liability must be claimed in contractual terms.

An empowered executive may be considered to be acting as a *de facto* director. This executive may act as a company director vis-à-vis third parties, particularly if the management body is somewhat inactive. As mentioned, in order for an executive to be held liable as a director, his/her conduct as a *de facto* director must be proved (his/her attorney status is insufficient). Otherwise, the executive will not be subject to directors' liability rules.

7 Measures to avoid incurring liability and defence against liability actions

Generally speaking, if the liability conditions included in general civil liability rules are not met, directors may not be held liable. Insofar as liability may be attributed to a director due to his/her wilful or negligent conduct, the director bears the burden of proving that he/she acted diligently in the company's best interest. When performing their functions, all directors should take these implications into account in order to adopt measures that evidence their diligent conduct, in the company's best interest. As mentioned, the law presumes that a director is acting diligently in relation to strategic and business decisions, if he/she is sufficiently informed and follows an adequate decision-making procedure.

This possible exemption from liability will also depend on the structure adopted by the management body. In the case of sole or joint and several directors, their individual action will be examined to determine whether they may be exempt from liability, if they meet the necessary requirements, specifically if they breach the required standard of care. If the management body is made up of joint directors or a board of directors, a director will not be liable for a harmful resolution or act if he/she is able to prove any of the following:

(i) That he/she did not participate in adopting and executing the harmful resolution or act and was unaware that it existed. Not participating in the harmful resolution or act must be justified and unawareness will cover both its existence and the subsequent adoption and execution of the resolution or act (not participating in the decision-making process does not suffice).

(ii) That he/she did not participate in adopting and executing the resolution, of which he/she was aware (e.g. if the director votes against the resolution or abstains). In this case, the director must

   a) have done everything that was reasonable to avoid the damage (e.g. to avoid its execution or to challenge the resolution in court), or

   b) have at least expressly challenged the harmful act or resolution (the director having voted against the resolution will not suffice; his/her express disagreement must be proven).

In no event will liability be excluded if the harmful act or resolution has been adopted, authorised or ratified by the general meeting. Consequently, a prior authorisation of an act or resolution by the general meeting, or its subsequent ratification, will not prevent later liability actions being brought against the directors.

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